1 UNITED STATES OF AMERICA,
District of Connecticut, ss:

I, Charles E. Pickett, clerk of the District Court of the United States of America for the District of Connecticut, Second Circuit, by virtue of the following writ of error, and in obedience thereto, do hereby certify that the pages number from 1 to 53, inclusive, contain a true and complete transcript of the record and proceedings had in said court in the cause of James J. Walsh, collector of internal revenue, plaintiff in error, against Frederick F. Brewster, defendant in error, as the same remain of record and on file in said office.

In testimony whereof I have caused the seal of the said court to be hereunto affixed, at the city of New Haven, in the District of Connecticut, in the Second Circuit, this 7th day of February, in the year of our Lord one thousand nine hundred and twenty-one, and of the Independence of the United States the one hundred and forty-fifth.

[SEAL.]

C. E. PICKETT,
Clerk.

2 WRIT OF ERROR.

UNITED STATES OF AMERICA, *ss:*

The President of the United States of America to the judge of the District Court of the United States for the District of Connecticut, greeting:

Because, in the record and proceedings, as also in the rendition of the judgment of a plea which is in the District Court, before you, between James J. Walsh, collector of internal revenue, plaintiff in error, against Frederick F. Brewster, defendant in error, a manifest error hath happened, to the great damage of the said James J. Walsh, collector of internal revenue, plaintiff in error, as is said and appears by his complaint, we, being willing that such error, if any hath been, should be duly corrected, and full and speedy justice done to the parties aforesaid in this behalf, do command you, if judgment be therein given, that then under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the Supreme Court of the United States, at the city of Washington, together with this writ, so that you have the same at the said place, before the Supreme Court of the United States aforesaid, within thirty days from the date hereof, that the record and proceedings aforesaid being inspected, the said Supreme Court of the United States may cause further to be done therein, to correct that error, what of right and according to the law and custom of the United States ought to be done.

Witness, the Honorable Edward D. White, Chief Justice of
3 United States, this 4th day of February, in the year of our Lord one thousand nine hundred and twenty-one, and of the Independence of the United States the one hundred and forty-fifth.

C. E. PICKETT,
Clerk of the District Court of the United States of America for the District of Connecticut, in the Second Circuit.

The foregoing writ is hereby allowed.

EDWIN S. THOMAS,
United States District Judge.

4 In the United States District Court for the District of Connecticut.

FREDERICK F. BREWSTER, PLAINTIFF,
vs.
JAMES J. WALSH, COLLECTOR OF internal revenue, defendant.

PETITION FOR WRIT OF ERROR.

To the Supreme Court of the United States of America:

The above-named James J. Walsh, collector of internal revenue, now appears before this court and complains that in the records and proceedings had in this cause, and also in the rendition of the judgment in the above-entitled cause, in the District Court of the United States for the District of Connecticut, on the 16th day of December, 1920, manifest error hath happened to the great damage of said defendant, all of which will more in detail appear from the assignment of errors which is filed with this petition.

Wherefore, the said defendant hereby prays that a writ of error may issue in his behalf from the Supreme Court of the United States to the United States District Court for the District of Connecticut for the correction of the errors and the reversal of the final order and judgment so complained of; that a transcript of the record, proceedings, and papers in this cause, duly authenticated, may be sent to the said Supreme Court of the United States; that said writ of error operate as a supersedeas; and that such other order and process issue as may cause the aforesaid errors and judgment to be corrected by the said Supreme Court of the United States.

Dated, Hartford, Connecticut, in the District of Connecticut, the 4th day of February, 1921.

ALLAN K. SMITH,
Assistant U. S. Attorney,
Attorney for the Defendant.

5 At a stated Term of the District Court of the United States, held in and for the District of Connecticut, at the courthouse, in the United States Post Office and Courthouse Building, in the city of New Haven, on the 4th day of February, 1921.

Present: Hon. Edwin S. Thomas, U. S. District Judge.

FREDERICK F. BREWSTER, PLAINTIFF,
against
JAMES J. WALSH, COLLECTOR OF INTERNAL REVENUE, DEFENDANT.

ORDER ALLOWING WRIT OF ERROR.

The above-named defendant, James J. Walsh, collector of internal revenue, having filed a petition for a writ of error and an assignment of errors in the above-entitled action, it is now

Ordered, that a writ of error be, and the same hereby is, allowed to have reviewed in the Supreme Court of the United States the record and proceedings and the judgment heretofore on the 16th day of December, 1920, rendered in this court in this cause.

EDWIN S. THOMAS,
U. S. District Judge.

6 United States District Court for the District of Connecticut.

FREDERICK F. BREWSTER, PLAINTIFF,
against
JAMES J. WALSH, COLLECTOR OF INTERNAL REVENUE, DEFENDANT.
Law. No. 2133.

UNITED STATES OF AMERICA,
District of Connecticut, ss:

The President of the United States of America to the marshal of the District of Connecticut, greeting:

You are hereby commanded to summon James J. Walsh, collector of internal revenue for the District of Connecticut, the defendant herein, to appear before the District Court of the United States for the District of Connecticut on the first Monday in March, 1919, then and there to answer unto Frederick F. Brewster, of the town of Hamden, in the State of Connecticut, the plaintiff herein, in a civil action wherein the plaintiff complains and says:

1. The plaintiff at all of the times hereinafter mentioned was and still is a citizen of the State of Connecticut and a resident of the internal revenue district of Connecticut.

2. At all of the times hereinafter mentioned the defendant was and still is collector of internal revenue of the United States for the District of Connecticut.

7 3. The plaintiff is not and was not at any of the times herein mentioned a member of any stock exchange or other similar organization or association for the purpose of trading in or buying or selling securities, nor was he a trader or dealer in stocks or bonds or engaged in the business of buying or selling stocks or bonds otherwise than as an investor, and as such occasionally purchasing stocks

and bonds for investment and occasionally buying and selling for the purpose of changing investments.

4. On or about April 19, 1899, plaintiff became the owner of $191,000 face value of certain interest-bearing bonds of International Navigation Company, a domestic corporation, the said bonds being described as first mortgage sinking fund bonds, which plaintiff acquired in exchange for certain notes and bonds of the said corporation, which were of the value of $191,000, and plaintiff continued to own said bonds until 1916, when he sold the same as hereinafter set forth.

5. On March 1st, 1913, first mortgage sinking fund bonds of International Navigation Company were depressed in the market and the market quotation therefor upon said day was 79½ asked and no bids, meaning that certain of said bonds were offered for sale in the market at 79½% of their face value.

6. During the calendar year 1916 the plaintiff sold said International Navigation Company first mortgage sinking fund bonds for the face value thereof, to wit, $191,000.

7. On or about March 6th, 1906, plaintiff became the owner of $257,000 face value of certain bonds of International Mercan-
8 tile Marine Company, a domestic corporation, such bonds being described as first mortgage bonds of said corporation, at a cost to the plaintiff as nearly as the same can be estimated of 106.2% of the face value thereof, to wit, $272,934, and the plaintiff continued to own said first mortgage bonds of International Mercantile Marine Company until 1916, when he sold the same as hereinafter set forth.

8. On March 1st, 1913, the first mortgage bonds of International Mercantile Marine Company were depressed in the market and the market quotation on said date was 64 bid and 64½ asked, meaning that certain of said bonds were offered for sale at 64½% of their face value and that an offer or offers were made to purchase the same at 64% of their face value.

9. During the calendar year 1916 the plaintiff sold $100,000 face value of said first mortgage bonds of said International Mercantile Marine Company at 107¾% of their face value and received therefor $107,375, and the plaintiff during said year likewise sold $157,000 face value of said bonds at 107¼% of their face value, and received therefor $168,775, in both cases for the sole purpose of and incident to making a change of investments.

10. On January 1st, 1916, the Standard Oil Company of California was, and had been for many years, and still is, a corporation organized and existing under and by virtue of the laws of the State of California, and on said date had an authorized capital stock of $100,000,000 divided into 1,000,000 shares of the nominal or par value of
9 $100 each and said corporation then had issued and outstanding stock of the nominal or par value of $49,686,656. On said date the said corporation had surplus assets and undivided profits invested in plant and property and used in the busi-

ness of and required for the purposes of the said corporation amounting to the sum of $44,852,263.02, of which $20,353,968.34 had been earned by said corporation prior to March 1st, 1913, and the balance of said surplus and undivided profits had been earned by said corporation subsequent to that date.

11. The board of directors of said Standard Oil Company of California at a meeting held on the 16th day of January, 1916, for the purpose of readjusting the capitalization of said corporation, determined to issue additional shares of stock constituting a stock dividend of 50% upon its outstanding capital stock from the authorized capital stock of said company, and to transfer from surplus account to capital stock account an amount equivalent to said stock dividend. The said board of directors duly adopted a resolution declaring said dividend as follows:

"Whereas the issued capital stock of this corporation consists of $496,866\frac{545,614}{983,383}$ shares of a par value of one hundred dollars ($100) each; and

Whereas the unissued capital stock of this corporation consists of $503,133\frac{437,769}{983,383}$ shares;

Whereas the net assets of this corporation exceeded the par value of the issued capital stock by far more than twenty-five million dollars ($25,000,000) and the surplus of this corporation is greatly in excess of twenty-five million dollars ($25,000,000); and

Whereas said surplus was derived from earnings of the corporation and profits of the business;

Now, therefore, be it

Resolved, That subject to the approval of the said authorities, a stock dividend of $248,433\frac{272,807}{983,383}$ shares of the capital stock of this corporation, of the par value of one hundred dollars ($100) each be, and the same is hereby, declared payable on April 15, 1916, or as soon thereafter as delivery can be made, to the stockholders of this corporation of record on its books at close of business March 4, 1916, in the proportion of one-half of a share for each share of stock then so owned and held by each of said stockholders as shown by said books.

Resolved further, That the president and secretary of this corporation are hereby authorized and empowered to take whatever steps they may deem necessary to carry this resolution into effect, and to notify the stockholders of the purport thereof."

12. Thereafter in accordance with said resolution the officers of said Standard Oil Company of California transferred from surplus account to capital stock account the sum of $24,843,327.74, being the equivalent of said stock dividend, and on or about the 15th day of April, 1916, issued to the stockholders of record of the said corporation on the 4th day of March, 1916, additional shares of stock in the

proportion of one share of new stock for each two shares of old stock held by each shareholder on said date.

13. On March 4th, 1916, the plaintiff was the owner of 1,330 shares of stock of the Standard Oil Company of California, and on
11 or about the 15th day of April, 1916, in accordance with the aforesaid action of said corporation, the plaintiff received from the Standard Oil Company of California certificates representing additional shares of stock amounting to 665 shares. Because of the issue of said additional shares constituting said stock dividend the actual value of each share of stock, the value of which was based solely upon the total assets of the company was decreased, and the proportional decrease in actual value was reflected by a decrease at the same time in the market value of each share. During the month prior to the declaration of said stock dividend and immediately thereafter, sales of the said stock had been made in the market at prices from $360 per share to $382 per share, whereas during the period after the issue of said stock dividend the price of said stock ranged from $234 per share to $268 per share. The actual value of the stock owned by each stockholder, including the plaintiff, was unchanged by reason of the declaration of said stock dividend and the issue of said additional shares of stock, the proportionate interest in the assets and business of said corporation being identically the same when represented by two shares of stock prior to the stock dividend and when represented by three shares of stock subsequent thereto.

14. By resolution of the board of directors of the Standard Oil Company of California the said sum of $24,843,327.74 equal to the par value of the shares of stock constituting the said stock dividend and charged from surplus account to capital account was to the amount of $20,353,068.34 charged against surplus and undivided profits of said corporation earned prior to March 1st, 1913, and the balance thereof, amounting to $4,490,259.40, was charged
12 against the first surplus profits of said corporation earned after March 1st, 1913, the result being that 18.0743% of said $24,843,327.74 was charged against surplus and undivided profits earned since March 1st, 1913.

15. In accordance with the provisions of the income tax law, being title 1 of an act of Congress in effect September 9, 1916, entitled "An act to increase the revenue and for other purposes," the plaintiff in the year 1917 duly filed his return of income received during the year 1916, and paid the tax assessed by the defendant as collector of internal revenue for the district of Connecticut thereon. In determining the amount of taxable income received by the plaintiff during the year 1916 and in ascertaining and fixing the income tax due thereon the sums received by the plaintiff from the sale of the aforesaid $191,000.00 face value of first mortgage sinking fund bonds of the International Navigation Company, the sums received from the sale of said $257,000 face value of first mortgage bonds of

International Mercantile Marine Company, and the said 665 shares of stock of the Standard Oil Company of California were excluded, but the plaintiff attached to his said return and filed therewith with said collector, a statement describing the said transactions and asserting that no taxable income was derived therefrom.

16. Thereafter the defendant, as collector of internal revenue for the district of Connecticut, claiming to act in pursuance of the provisions of the said income tax law demanded of the plaintiff the sum of $17,689.13, which the defendant claimed to be due and payable, after giving credit to the plaintiff for an excess payment of normal income tax of $67.66, as an income tax on $150,825,
13 alleged to be profit upon the sale of said International Navigation Company and said International Mercantile Marine Company bonds, and $12,919.41 on said 665 shares of stock of the Standard Oil Company of California received by the plaintiff as aforesaid in the year 1916, and which said sum of $150,825 and 18.0743% of the par value of said stock the defendant claimed to constitute taxable income; and the defendant threatened to enforce the payment of said tax, together with the penalties and interest as provided in the act, by distraint and sale of property. And thereupon the plaintiff solely to avoid the imposition of penalties and interest, and under compulsion, duress and coercion, paid to the defendant as such collector, on or about the 19th day of July, 1918, the sum of $17,689.13, but under protest, and at the same time protested in writing that no tax was due from the plaintiff, but that on the contrary the United States was indebted to the plaintiff in the sum of $67.66, constituting an over-payment of the normal tax due upon plaintiff's income for the year ending December 31, 1916, and that the plaintiff paid the same under duress and compulsion.

17. Thereafter the plaintiff duly took an appeal to the Commissioner of Internal Revenue and demanded repayment of said tax, in accordance with law and the regulations and rules of the Treasury Department. Said appeal was duly perfected and filed with the Commissioner of Internal Revenue on or about the 14th day of September, 1918, and thereafter on or about the 21st day of January, 1919, said Commissioner of Internal Revenue refused to grant said appeal and rejected plaintiff's claim for a refund of said sum of $17,689.13 paid as aforesaid, or any part thereof.

14 18. The difference between the market price of the aforesaid first mortgage sinking fund bonds of International Navigation Company and said first mortgage bonds of the International Mercantile Marine Company, and the amounts received therefor by plaintiff upon the sale thereof, and the additional shares constituting the aforesaid stock dividend of the Standard Oil Company of California, notwithstanding the fact that 18.0743% thereof was charged against earnings and profits accrued since March 1st, 1913, did not constitute taxable income under the income tax law. No tax was due or has become due thereon to the United States Government or to the defendant as collector of internal revenue for the

district of Connecticut, and the amount of tax paid thereon, viz, $17,689.13, together with the retention of the sum of $67.66 over-payment of normal tax as aforesaid, was illegally and without warrant or authority or within the law, demanded and collected by the defendant from the plaintiff.

19. The act of Congress under which the aforesaid sum of $17,689.13, together with the aforesaid retention of $67.66 over-payment of normal tax was levied as aforesaid and its payment compelled, to wit, title 1 of an act of Congress, entitled "An act to increase the revenue, and for other purposes," is invalid and void in so far as the same may be asserted to empower the aforesaid levy of income tax on the proceeds of the sales of the aforesaid bonds of the International Navigation Company and the International Mercantile Marine Company, and on said additional shares constituting the said stock dividend issued by said Standard Oil Company of California,
15 or to compel such payment as aforesaid because in so far as it be asserted to accomplish such purposes it is in violation of the provisions of article 1, section 2, clause 3 of the Constitution of the United States, which provides that "direct taxes shall be apportioned among the several States," and of the provisions of article 1, section 9, clause 4 thereof to the effect that "No capitation, or other direct, tax shall be laid, unless in proportion to the census or enumeration hereinbefore directed to be taken." The said difference between the market price of the said bonds on March 1st, 1913, and the amount received by the sale thereof, and said additional shares issued to the plaintiff as aforesaid and constituting said stock dividend, did not in whole or in any part or proportion thereof constitute income and was not subject to taxation as income within the meaning of the provisions of the XVIth amendment of said Constitution to the effect that "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration"; and the plaintiff draws in question the constitutionality of the said act of Congress and of all provisions thereof assumed or asserted to authorize the said levy and the enforcement thereof.

20. No part of said sum of $17,689.13 or said sum of $67.66, retained as aforesaid, has been repaid to the plaintiff, and the whole amount thereof with interest thereon from the 19th day of July, 1918, remains due and owing from this defendant to this plaintiff.

21. This is a suit of a civil nature at common law, and the matter in controversy exceeds, exclusive of interest and costs, the sum
16 of $3,000, and this suit and the cause of action herein set forth arise under the Constitution and laws of the United States providing for internal revenue.

Wherefore, the plaintiff claims and demands judgment against the defendant for the sum of $17,756.79 with interest thereon from the 19th day of July, 1918, together with the costs and disbursements of this action.

Henry F. Parmelee, of New Haven, is recognized in the sum of $150.00 to prosecute, etc.

Hereof fail not, but of this writ due service and return make.

Witness the Honorable Edwin S. Thomas, judge of the District Court of the United States, for the District of Connecticut, and the seal of said court, at Hartford, in said district, this 10th day of February, A. D. 1919.

C. E. PICKETT,
Clerk of the District Court of the United States, for the District of Connecticut.
HENRY F. PARMELEE,
Attorney for Plaintiff, Office and Post Office Address, #865 Chapel Street, New Haven, Conn.
GEORGE D. WATROUS,
HENRY F. PARMELEE,
Of Counsel.

HARTFORD, CONN.,
February 10, 1919.

UNITED STATES OF AMERICA,
District of Connecticut:

By virtue hereof I made due service by leaving a true and attested copy of this writ in the hands of James J. Walsh, collector of internal revenue.

Attest:

C. C. MIDDLEBROOKS,
U. S. Marshal.
By T. E. HAWLEY,
Deputy U. S. Marshal.

Fees:

1 mile	.06
1 service	2.00
	2.06

Expenses: Trolley, Hartford, .12.

17 United States District Court for the District of Connecticut.

FREDERICK F. BREWSTER, PLAINTIFF,
vs.
JAMES J. WALSH, COLLECTOR OF INTERNAL REVENUE, DEFENDANT.
No. 2133.

ANSWER.

1. Paragraphs 1, 2, 3, 6, 9, 10, 11, 12, 14, 15, 17, and 21 of plaintiff's complaint are admitted.

2. Paragraphs 18 and 19 are denied.

3. The defendant admits the allegations of paragraph 4, excepting so much thereof as alleges that the plaintiff exchanged for said bonds

certain notes and bonds of the value of $191,000.00, as to which allegation the defendant has not sufficient knowledge or information to form a belief and leaves the plaintiff to his proof thereof.

4. The defendant denies the truth of the matters contained in paragraph 5 excepting so much thereof as alleges that the market quotation for the first mortgage sinking fund bonds of International Navigation Company on March 1st, 1913, was 79½ per cent asked and no bids, meaning that certain of said bonds were offered for sale in the market at 79½ per cent of their face value and the defendant alleges that the annual range of prices for said bonds during the years 1912, 1913, and 1914, stated in percentage of their face value, was as follows:

18

1912.

High---------- 82½ (April). Low---------- 77¾ (October).

1913.

High---------- 79¾ (January). Low---------- 75 (November).

1914.

High ---------- 77½. Low---------- 71⅝.

It thus appears that the price on March 1st, 1913, was not depressed but was near the highest price for that year, and higher than the price during part of the year 1912 and all the year 1914.

5. The defendant admits the allegations of paragraph 7, excepting so much thereof as alleges the consideration paid for said bonds of International Mercantile Marine Company as to which allegation the defendant has not sufficient knowledge or information to form a belief and leaves the plaintiff to his proof thereof.

6. The defendant denies the truth of the matters contained in paragraph 8 of the plaintiff's complaint excepting so much thereof as alleges that on March 1st, 1913, the market quotation of the first mortgage bonds of the International Mercantile Marine Company was 64 bid and 64½ asked, meaning that certain of said bonds were offered for sale at 64½ per cent of their face value and that an offer or offers were made to purchase the same at 64 per cent of their face value, and the defendant alleges that the annual range of prices of said bonds during the years 1912, 1913, 1914, and 1915 stated in percentage of their face value, was as follows:

1912.

High ---------- 70⅝ (March). Low---------- 63 (April).

1913.

High---------- 66⅛ (January). Low---------- 56½ (June).

1914.

High---------- 61 (January). Low ---------- 29¾ (December).

19 1915.

High---------- 97½ (December). Low ---------- 30¼ (January).

It thus appears that the price on March 1st, 1913, was not depressed but was near the highest price for that year, and higher than the price during part of the year 1912, and all the year 1914.

7. The defendant alleges that on March 1, 1913, and for a long time prior thereto, the plaintiff had been the owner of 1,330 shares of the capital stock of the Standard Oil Company of California. The defendant denies the truth of the matters contained in paragraph 13 of the plaintiff's complaint excepting so much thereof as alleges that on March 4th, 1916, the plaintiff was the owner of 1,330 shares of stock of the Standard Oil Company of California and on or about April 15th, 1916, the plaintiff received from the Standard Oil Company of California certificates representing additional shares of stock amounting to 665 shares; and the defendant alleges that the said Standard Oil Company of California declared a 50 per cent dividend on April 15th, 1916, and a stock dividend of 33⅓ per cent on April 15th, 1917, and that said Standard Oil Company of California, during the years 1908 to 1918, inclusive, paid cash dividends upon its capital stock as follows:

1908	10 %	Cash.
1909	46 %	"
1910	12 %	"
1911	None.	
1912	2½%	"
1913	10 %	"
1914	10 %	"
1915	10 %	"
1916	10 %	"
1917	10 %	"

20 and the defendant further alleges that the weekly range of prices per share of the capital stock of the said Standard Oil Company of California for the years 1913 to 1918, inclusive, which was the fair market value of said shares of stock, is set forth in the table attached hereto as Exhibit A. This table shows the value and market price of said stock before and after the declaration and payment of said dividends.

8. The defendant denies the truth of the matters contained in paragraph 16 of the plaintiff's complaint excepting so much thereof as alleges that the defendant in pursuance of an act of Congress in effect September 9th, 1916, demanded of the plaintiff the sum of $17,689.13 after giving credit to the plaintiff for an excess payment of normal income tax of $67.66, as an income tax on a $150,325.00

profit upon the sale of said International Navigation Company and said International Mercantile Marine Company bonds, and $12,019.41, which is 18.0743 per cent of the face or par value of the 665 shares of stock of the Standard Oil Company of California received by the plaintiff in the year 1916, which said sum of $150,825.00 and $12,019.41 defendant alleges constituted taxable income of the plaintiff, and the defendant further admits the payment of the sum of $17,689.13 on or about July 19th, 1918.

9. The defendant denies the truth of the matters contained in paragraph 20 of the plaintiff's complaint excepting so much thereof as alleges that no part of said sum of $17,689.13 or said sum of $67.66 has been repaid to the plaintiff.

DEFENDANT,
By ALLAN K. SMITH,
Assistant U. S. Attorney.

21 United States District Court, District of Connecticut.

FREDERICK F. BREWSTER, PLAINTIFF,
vs.
JAMES J. WALSH, COLLECTOR OF INTERNAL REVENUE, defendant. } Law. No. 2133.

REPLY.

1. So much of paragraph 4 of the defendant's answer as states "the annual range of prices for said bonds during the years 1912, 1913, and 1914," is admitted.

2. So much of paragraph 4 of said answer as states "it thus appears that the price on March 1st, 1913, was not depressed," is denied.

3. So much of paragraph 6 of said answer as states, "the annual range of prices of said bonds during the years 1912, 1913, 1914, and 1915," is admitted.

4. So much of paragraph 6 of said answer as alleges "it thus appears that the price on March 1st, 1913, was not depressed," is denied.

5. The plaintiff admits the truth of the affirmative allegations contained in paragraph 7 of said answer and the exhibit therein referred to.

FREDERICK F. BREWSTER,
Plaintiff.
By HENRY F. PARMELEE,
His Attorney.

May 20th, 1920.

22 United States District Court, District of Connecticut.

FREDERICK F. BREWSTER, PLAINTIFF,
v.
JAMES J. WALSH, COLLECTOR OF INTERNAL REVENUE, defendant. } LAW. No. 2133.

STIPULATION.

The parties to the above-entitled cause hereby stipulate and agree that the following statement shall be considered as a statement of facts to be used in evidence on trial of said cause without precluding the right of either party thereto to refer to the pleadings on file or to object to the materiality of any fact stated therein.

Statement of facts.

1. Frederick F. Brewster, the plaintiff herein, is a citizen of the State of Connecticut and subject to the valid provisions of the income tax law in effect September 8th, 1916, entitled "An act to increase the revenue and for other purposes."

2. The defendant is and has been the collector of internal revenue of the United States for the State of Connecticut since September 1st, 1913.

3. The plaintiff is not and was not at any of the times herein mentioned, a member of any stock exchange or other similar or-
23 ganization or association for the purpose of trading in or buying or selling securities, nor was he a trader or dealer in stock or bonds or engaged in the business of buying or selling stocks or bonds otherwise than as an investor, and as such occasionally purchasing stocks and bonds for investment, and occasionally buying and selling for the purpose of changing investments.

4. On or about April 19, 1899, the plaintiff became the owner of $191,000 face value of certain interest-bearing bonds of International Navigation Company, a domestic corporation, the said bonds being described as first mortgage sinking fund bonds. These bonds were then of the value of $191,000 and were obtained by the plaintiff in exchange for various securities of the same corporation of the value of $191,000, which the plaintiff had obtained by inheritance. The plaintiff continued to own said bonds until 1916, when he sold the same for $191,000, being the face value thereof.

5. On March 1st, 1913, the first mortgage sinking fund bonds of International Navigation Company were quoted in the market at 79½ per cent asked and no bids, meaning that certain of said bonds were offered for sale in the market at 79½ per cent of their face value, and the annual range of prices for said bonds during the years 1912, 1913, and 1914 stated in percentage of their face values, was as follows:

1912.

High---------- 82½ (April). Low---------- 75¼ (October).

1913.

High---------- 79¼ (January). Low---------- 75 (November).

1914.

High---------- 77½. Low---------- 71½.

24 6. The plaintiff, pursuant to an underwriting agreement to which he was a party, was allotted a participation of $257,000, and paid to the underwriting syndicate during the years 1902 and 1903 the sum of $257,000 in cash. The plaintiff received nothing by way of interest or otherwise from such payment until March 6th, 1906, when he received $257,000 face value in first mortgage bonds of the International Mercantile Marine Company, 5% of the amount of the $257,000 subscription in 6% preferred stock in the same company, less 20% of the same which was allotted to the managers of the syndicate, and 50% of the amount of his subscription of $257,000 in common stock of the same corporation, less 20% of the same which was assigned to the syndicate managers. It is agreed that by this transaction the plaintiff paid in cash during the years 1902 and 1903, 90% of the face value thereof for said first mortgage bonds, to wit, $231,300, the balance of said payment of $257,000 being for the stock received therewith.

It is further agreed that if interest at the rate of 6% per annum during the period between the payment on the underwriting agreement and the allotment of securities is a part of the cost of said bonds, the cost thereof to the plaintiff was 106 $\frac{7}{10}$ths per cent of the face value thereof, to wit, $272,934. If such interest does not constitute a part of the cost of said bonds to the plaintiff the cost thereof was 90% of the face value thereof, to wit, $231,300.

The plaintiff continued to own all of said bonds until 1916 when he sold $100,000 face value thereof at 107¾ per cent of their face value, viz, $107,375.00, and the remainder, viz. $157,000 face value at 107½ per cent of their face value, viz, $168,775.00.

25 7. On March 1st, 1913, the market quotation of the first mortgage bonds of International Mercantile Marine Company was 64 bid and 64½ asked, meaning that certain of said bonds were offered for sale at 64½ per cent of their face value and that an offer or offers were made to purchase same at 64 per cent of their face value, and the annual range of prices of said bonds during the years 1912, 1913, 1914, and 1915 stated in percentage of their face value, was as follows:

1912.

High------70⅜ (March). Low------ 63 (April).

1913.

High------ 66¼ (January). Low------ 56½ (June).

1914.

High------ 61 (January). Low------ 29¼ (December).

1915.

High------ 97½ (December). Low------ 30¼ (January).

8. On March 1st, 1913, and for a long time prior thereto, the plaintiff had been the owner of 1,330 shares of the capital stock of the Standard Oil Company of California. On January 1st, 1916, the Standard Oil Company of California was and had been for many years, and still is, a corporation organized and existing under and by virtue of the laws of the State of California, and on said date had an authorized capital stock of $100,000,000.00 divided into 1,000,000 shares of the nominal or par value of $100 each, and said corporation then had issued and outstanding stock of the nominal or par value of $49,686,656.00. On said date the said corporation had surplus assets and undivided profits amounting to the sum of $44,852,263.02, of which $20,353,068.34 had been earned by said
26 corporation prior to March 1st, 1913, and the balance of said surplus and undivided profits had been earned by said corporation subsequent to that date.

9. The board of directors of the Standard Oil Company of California at a meeting held on the 16th day of January, 1916, determined to issue additional shares of stock constituting a stock dividend of 50 per cent upon its outstanding capital stock from the authorized capital stock of said company, and to transfer from surplus account to capital stock account an amount equivalent to said stock dividend. The said board of directors adopted a resolution declaring said dividend as follows:

"Whereas the issued capital stock of this corporation consists of $496{,}866\ \frac{545{,}614}{983{,}383}$ shares of a par value of one hundred dollars ($100) each; and

"Whereas the unissued capital stock of this corporation consists of $503{,}133\ \frac{437{,}769}{983{,}383}$ shares;

"Whereas the net assets of this corporation exceed the par value of the issued capital stock by far more than twenty-five million dollars ($25,000,000) and the surplus of this corporation is greatly in excess of twenty-five million ($25,000,000) dollars, and

"Whereas said surplus was derived from earnings of the corporation and profits of the business; Now, therefore, be it

"Resolved, That subject to the approval of the said authorities, a stock dividend of $248{,}433\ \frac{272{,}807}{983{,}383}$ shares of the capital stock of this corporation, of the par value of one hundred ($100) dollars each be

and the same is hereby declared, payable on April 15th, 1916, or as soon thereafter as delivery can be made, to the stockholders of
27 this corporation of record on its books at close of business March 4th, 1916, in the proportion of one-half of a share for each share of stock then so owned and held by each of said stockholders as shown by said books.

"*Resolved further*, That the president and secretary of this corporation are hereby authorized and empowered to take whatever steps they may deem necessary to carry this resolution into effect and to notify the stockholders of the purport thereof."

10. Thereafter in accordance with said resolution the officers of said Standard Oil Company of California transferred from surplus account to capital stock account the sum of $24,843,327.74, being the equivalent of said stock dividend, and on or about the 15th day of April, 1916, issued to the stockholders of record of the said corporation on the 4th day of March, 1916, additional shares of stock in the proportion of one share of new stock for each two shares of old stock held by each shareholder on said date.

11. On March 4th, 1916, the plaintiff was the owner of 1,330 shares of stock of the Standard Oil Company of California and on or about the 15th day of April, 1916, in accordance with the aforesaid action of said corporation the plaintiff received from the Standard Oil Company of California certificates representing additional shares of stock amounting to 665 shares of a par value of $100.00 per share and an actual and market value of approximately $250.00 per share.

12. The hereinbefore described stock dividend is the stock dividend which was before the Supreme Court in Macomber v. Eisner, decided March 8, 1920.

13. By resolution of the board of directors of the Standard Oil Company of California the said sum of $24,843,327.74, equal
28 to the par value of the shares of stock constituting the said stock dividend and charged from surplus account to capital account was to the amount of $20,353,068.34 charged against surplus and undivided profits of said corporation earned prior to March 1st, 1913, and the balance thereof amounting to $4,490,259.40 was charged against the first surplus profits of said corporation earned after March 1st, 1913, the result being that 18.0743 per cent of $24,843,327.74 was charged against surplus and undivided profits earned since March 1st, 1913.

14. The plaintiff in the year 1917 filed a return of income received during the year 1916 and paid a tax assessed by the defendant as collector of internal revenue for the District of Connecticut thereon. In determining the amount of taxable income received by the plaintiff during the year 1916 and in ascertaining and fixing the income tax due thereon, plaintiff excluded the sums received by him from the sale of the aforesaid $191,000.00 face value of first mortgage sinking fund bonds of the International Navigation Company, the sums received from the sale of said $257,000.00 face value of the

first mortgage bonds of International Mercantile Marine Company, and the said 665 shares of stock of the Standard Oil Company of California, but plaintiff attached to his said return and filed therewith a statement describing the said transactions and asserting that no taxable income was derived therefrom.

15. The defendant in pursuance of an act of Congress in effect September 8th, 1916, demanded of the plaintiff the sum of $17,689.13 after giving credit to the plaintiff for an excess payment of normal income tax of $67.66 as an income tax on a $150,825.00 profit upon the same of said International Navigation Company and said
29 International Mercantile Marine Company bonds, and $12,019.41, which is 18.0743 per cent of the face or par value of the 665 shares of stock of the Standard Oil Company of California received by the plaintiff in the year 1916, and the defendant further admits the payment of the sum of $17,689.13 on or about July 18th, 1918, under protest, which sum has not been repaid to the plaintiff.

16. The said Standard Oil Company of California declared a 50% stock dividend on January 15, 1916, payable April 15, 1916, to stockholders of record of March 4, 1916, and on or about January 15, 1917, declared a 33⅓% stock dividend, payable April 16, 1917, to stockholders of record of February 15, 1917. The said Standard Oil Company of California during the years 1908 to 1918, inclusive, paid each dividends upon its capital stock as follows:

1908		
1909	10%	cash.
1910	46%	"
1911	12%	"
1912	None.	
1913	2½%	"
1914	10%	"
1915	10%	"
1916	10%	"
1917	10%	"

The weekly range of prices per share of the shares of the capital stock of said Standard Oil Company of California from March, 1913, to 1918, inclusive, which was the fair market value of said shares of stock, is set forth in the table attached to the Answer as filed herein as Exhibit "A." This table shows the fair value
30 and market price of said stock before and after the dates fixed for closing transfer books in the above mentioned declarations of stock dividends, i. e., March 4, 1916, and February 15, 1917. The fair value of said stock per share on March 1st, 1913, did not exceed $173.00. The fair value of said stock at the present time is not less than $320 per share on June 7, 1920.

17. Thereafter the plaintiff took an appeal to the Commissioner of Internal Revenue and demanded repayment of said tax in accordance with law and the regulations and rules of the Treasury Department. Said appeal was duly perfected and filed with the Commis-

sioner of Internal Revenue on or about the 14th day of September, 1918, and thereafter on or about the 21st day of January, 1919, said Commissioner of Internal Revenue refused to grant said appeal and rejected plaintiff's claim for a refund of said sum of $17,689.13 paid as aforesaid, or any part thereof.

HENRY F. PARMELEE,
Attorney for the Plaintiff.
ALLAN K. SMITH,
Assistant U. S. Attorney.

30] United States District Court, for the District of Connecticut.

FREDERICK F. BREWSTER, PLAINTIFF,
against
JAMES J. WALSH, COLLECTOR OF INTERNAL REVENUE, defendant. } LAW. No. 2133.

STIPULATION.

In the above entitled cause it is hereby stipulated by and between the attorneys for the respective parties that the case be tried to the court without a jury, both parties hereby waiving jury trial of the issues herein.

HENRY F. PARMELEE,
Attorney for Plaintiff.
ALLAN K. SMITH,
Attorney for Defendant.

May 18, 1920.

31 District Court of the United States, District of Connecticut.

FREDERICK F. BREWSTER
vs.
JAMES J. WALSH, COLLECTOR OF INTERNAL REVENUE. } No. 2133. At law.

Henry F. Parmelee, Esq., New Haven, Conn.; George D. Watrous, Esq., New Haven, Conn., for plaintiff.
Edward L. Smith, Esq., United States attorney; Allan K. Smith, Esq., Ass't United States attorney, for defendant.

THOMAS, District Judge:

This action arises under the income tax law of 1916. The plaintiff seeks to recover of the defendant, who is collector of internal revenue for the district of Connecticut, $17,689.13, which amount the plaintiff paid to the Government under protest, as an additional income tax assessed against him for the year ending December 31, 1916. The plaintiff further claims that there is also due him the additional sum

of $67.66 which the Government concedes was an over-payment of normal tax and is rightly due the plaintiff, so that the total amount claimed by the plaintiff is $17,756.79. Trial by jury was waived, and the case was tried to the court.

The facts are stipulated. It appears that the plaintiff is not now nor was he during the times mentioned herein, a member of any stock exchange, or of any similar organization or association engaged in the business of trading in, buying, or selling securities. Neither was he in any way engaged in the business of buying or selling stocks and bonds, otherwise than occasionally making purchases of
32 stocks and bonds for investment purposes, and occasionally making sales of such stocks and bonds for the purpose of changing the character of his investments. It further appears that there are three transactions involved in the main points raised in this suit.

The first transaction concerns the bonds of the International Navigation Company. In 1899 the plaintiff acquired certain interest bearing bonds of that company of the face value of $191,000 in exchange for other securities of the same corporation, and during the year 1916 he sold the same bonds for $191,000. On March 1, 1913, these bonds were quoted in the market at 79½ of their face value, so that on that day the market value of the bonds was $151,845. The tax sought to be collected by the Government on this transaction is based upon the difference between the sale price and the market price of the bonds on March 1, 1913, to wit, $39,155, which amount the commissioner taxed as income for the year 1916, and is part of the tax paid under protest which plaintiff seeks to recover in this suit.

The second transaction concerns certain bonds of the International Mercantile Marine Company. In 1903, plaintiff, as a member of an underwriting syndicate, was granted an allotment of mortgage bonds of the face value of $257,000, in return for which he paid the company at that time $231,300 in cash, but the bonds thus allotted were not delivered to the plaintiff until April, 1906, when he received them with nothing by way of interest on the amount of cash he had turned over to the company in 1903. The plaintiff claims that interest at 6% for three years on $231,300 is properly an element of cost and attributable thereto.
33 It becomes necessary at this point to digress from a statement of the facts and first dispose of plaintiff's claim for interest on this transaction, in order to determine what the bonds actually cost the plaintiff, as the actual cost must be determined before consideration can be given to the plaintiff's claims respecting the tax the commissioner assessed and which plaintiff paid under protest, pursuant to such assessment. Plaintiff's claim that interest computed from date of payment in 1903 to date of receipt of bonds in 1906, and added to the cash paid for the bonds represents the real cost of the bonds to the plaintiff is untenable.

In Hays vs. Gauley Mountain Coal Co., 247 U. S., 189, one of the questions there presented was whether the respondent should be allowed to add interest to the amount of cash it had paid in 1902 for certain shares of the capital stock of another mining company which shares it sold in 1911, but the Supreme Court held that there was "no merit in the contention that interest should be added to the purchase price in order to ascertain its cost," so that I find that the actual cost of these bonds to the plaintiff was $231,300.

From the stipulation it further appears that the plaintiff sold the bonds in 1916 for $276,150, part of them having been sold at 107½ and part at 107¼. But on March 1, 1913, the market quotation and market value of these bonds was 64 bid and 64½ asked and at such quotation had an actual market value of $164,480. On this transaction the plaintiff failed to make an income tax return as to any profit or gain by him obtained on the sale of these bonds and was later assessed an additional tax on $111,670 on the ground that this was the representative gain shown by the difference be-
34 tween $164,480, the value of said bonds as indicated by the market quotation of March 1, 1913, and $276,150, the price which plaintiff received from the sale of the bonds in 1916. The tax which was assessed on this transaction by the commissioner, and paid under protest, and which is part of the tax here sought to be recovered, was levied upon the sum of $111,670, which amount the Government claims represents the income received from the sale of these bonds and which amount, as stated above, was the difference between the market value of the bonds on March 1, 1913, and the sum received for them when sold in 1916.

The third transaction relates to a stock dividend declared by the Standard Oil Company of California in which company the plaintiff owned 1,330 shares of its capital stock. In 1916 the plaintiff received 665 shares of stock of said company as a stock dividend declared against a surplus, 18.0754% of which had been earned after March 1, 1913. The Government claims that the plaintiff derived $12,019.41 taxable income therefrom, but this claim has been decided adversely to the Government in Eisner vs. Macomber, 252 U. S., 189, where the identical stock dividend was under consideration, so that the plaintiff, upon that authority, is entitled to recover for the tax assessed and collected in connection with this transaction.

The discussion is therefore narrowed to two transactions, those pertaining to—

(a) The International Navigation Company bonds,
(b) The International Mercantile Marine Company bonds,

both of which the plaintiff owned on and before March 1, 1913, and which he sold in 1916, in accordance with the conditions above set forth. So that the sole inquiry here is, whether the difference
35 in the amounts between the value of investment securities on March 1, 1913, and the amounts received for such securities when sold in 1916 is taxable income within the income tax law of 1916 (39 Stat., c. 463, pp. 756, 757).

The discussion of this proposition revolves around the sixteenth amendment of the Constitution and the legislation passed by the Congress after the ratification of the amendment.

The sixteenth amendment to the Constitution provides:

"The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

The pertinent sections of the statute passed by the Congress to carry the amendment into effect provide:

"Sec. 1. (a) That there shall be levied, assessed, collected, and paid annually upon the entire net income received in the preceding calendar year from all sources by every individual, a citizen or resident of the United States, a tax of two per centum upon such income."

"Sec. 2. (b) That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever: Provided, That the term 'dividends' as used in this title shall be held to mean any distribution made or ordered to be made by a corporation, joint-stock company, association, or insurance company, out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation, joint-stock company, association, or insurance company, which stock dividend shall be considered income, to the amount of its cash value."

36 It is thus apparent that the statute specifically imposes a tax upon net income which "shall include gains, profits, and income derived from * * * sales or dealings in property," and then provides:

"(c) For the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived."

It is the contention of the plaintiff that the statute is unconstitutional in so far as it taxes as income the increased value of investments when realized by sale, and that such a tax is a direct tax upon capital or property not authorized by the sixteenth amendment and not a tax upon income. In other words, that such gains do not come

within the definition of income as the word is used in the sixteenth amendment.

On the other hand, it is the contention of the Government that such gains do constitute income properly taxable under the income tax law of 1916.

We are therefore brought to a consideration of the scope of the sixteenth amendment, because there is no question but that prior to the adoption of this amendment the Congress had no power whatever to tax as income gains arising from the sale of property where the owner thereof was not a dealer or trader in such property so as to justify an excise tax upon his business.

In support of this, reference is made to the decision of the Supreme Court in Pollock v. Farmers' Loan & Trust Co., 158 U. S., 601. The conclusion stated by Chief Justice Fuller, on page 637, is as follows:

37 "Taxes on personal property, or on the income of personal property, are likewise direct taxes," and that "the tax imposed by sections twenty-seven to thirty-seven, inclusive, of the act of 1894, so far as it falls on the income of real estate and of personal property, being a direct tax within the meaning of the Constitution, and therefore unconstitutional and void because not apportioned according to representation, all those sections * * * are necessarily invalid."

In Eisner v. Macomber, supra, Mr. Justice Pitney, speaking of the Pollock case, said on page 205:

"It was held that taxes upon rents and profits of real estate and upon returns from investments of personal property were in effect direct taxes upon the property from which such income arose, imposed by reason of ownership; and that Congress could not impose such taxes without apportioning them among the States according to population, as required by Article I, section 2, clause 3, and section 9, clause 4, of the original Constitution."

The sixteenth amendment does not extend the taxing power to new subjects. In Evans v. Gore, 253 U. S., 245, at page 261, Mr. Justice Van Devanter in delivering the opinion of the Supreme Court said:

"Thus the genesis and words of the amendment unite in showing that it does not extend the taxing power to new or excepted subjects, but merely removes all occasion otherwise existing for an apportionment among the States of taxes laid on income, whether derived from one source or another."

And again in Eisner vs. Macomber, supra, at page 206, Mr. Justice Pitney, in discussing the scope of the amendment, said:

"As repeatedly held, this did not extend the taxing power to new subjects, but merely removed the necessity which otherwise might exist for an apportionment among the States of taxes laid on income. Brushaber v. Union Pacific R. R. Co., 240 U. S., 1, 17–19; Stanton v. Baltic Mining Co., 240 U. S., 103, 112 et seq.; Peck & Co. v. Lowe, 247 U. S., 165, 172–173.

"A proper regard for its genesis, as well as its very clear language, requires also that this amendment shall not be extended by
38 loose construction, so as to repeal or modify, except as applied to income, those provisions of the Constitution that require an apportionment according to population for direct taxes upon property, real and personal. This limitation still has an appropriate and important function, and is not to be overrid'en by Congress or disregarded by the courts.

"In order therefore that the clauses cited from Article I of the Constitution may have proper force and effect, save only as modified by the amendment, and that the latter also may have proper effect, it becomes essential to distinguish between what is and what is not 'income,' as the term is there used; and to apply the distinction, as cases arise, according to truth and substance, without regard to form. Congress can not by any definition it may adopt conclude the matter, since it can not by legislation alter the Constitution, from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised."

In the case at bar it therefore "becomes essential to distinguish between what is and what is not 'income' as the term is used in the sixteenth amendment * * * and to apply the distinction according to truth and substance without regard to form," in order that Article I of the original Constitution, section 2, clause 3, and section 9, clause 4, may have proper force and effect save only as modified by the sixteenth amendment.

The question therefore is simply this: Is a gain in value realized from the sale of property income?

Insisting with great earnestness, with persuasive argument, and the citation of cases alleged to be in support of its argument, the Government contends that the answer is—Yes. The plaintiff, with equal forcefulness, contends that the answer is—No.

But the cases relied upon by the Government arose under the corporation tax act of 1909 and not under an income tax law. The corporation tax act of 1909, as held by the Supreme Court in Strat-
ton's Independence v. Howbert, 231 U. S., 399, 414, 416, was not
39 an income tax law, and since gains by sales were specifically included as taxable, the cases decided under that act do not determine the definition of the word "income" within the sixteenth amendment and so are not apposite to the instant case.

Mr. Justice Pitney, in the Stratton's Independence case, supra, on page 414, said:

"As has been repeatedly remarked, the corporation tax act of 1909 was not intended to be and is not in any proper sense an income tax law. This court had decided in the Pollock case that the income tax law of 1894 amounted in effect to a direct tax upon property, and was invalid because not apportioned according to population as prescribed by the Constitution. The act of 1909 avoided this difficulty by imposing not an income tax but an excise tax upon the conduct of business in a corporate capacity, measuring, however, the

amount of tax by the income of the corporation, with certain qualifications prescribed by the act itself. Flint v. Stone-Tracy Co., 220 U. S., 107; McCoach v. Minehill Co., 228 U. S., 295; United States v. Whitridge (decided at this term, ante, p. 144)."

And again on page 416 he said:

"As to what should be deemed 'income' within the meaning of sec. 38, it, of course, need not be such an income as would have been taxable as such, for at that time (the sixteenth amendment not having been as yet ratified), income was not taxable as such by Congress without apportionment according to population, and this tax was not so apportioned. Evidently Congress adopted the income as the measure of the tax to be imposed with respect to the doing of business in corporate form because it desired that the exercise should be imposed, approximately at least, with regard to the amount of benefit presumably derived by such corporations from the current operations of the Government. In Flint v. Stone-Tracy Co., 220 U. S., 107, 165, it was held that Congress, in exercising the right to tax a legitimate subject of taxation as a franchise or privilege, was not debarred by the Constitution from measuring the taxation by the total income, although derived in part from property, which, considered by itself, was not taxable. It was reasonable that Congress should fix upon gross income, without distinction as to source, as a convenient and sufficiently accurate index of the importance of the business transacted."

See also Anderson v. Forty-Two Broadway, 239 U. S., 69, 72;
40 Stanton v. Baltic Mining Co., 240 U. S., 103, 114; Von Baumbach v. Sargent Land Co., 242 U. S., 503, 522; Doyle v. Mitchell Bros. Co., 247 U. S., 179, 183.

The question before us was passed upon by the Supreme Court under the income-tax law of 1867 in Gray v. Darlington, 15 Wallace, 63, and this precise question has not been before the Supreme Court since that decision. There it was decided that under the law of 1867 a gradual increase in value extending over a period of years could not be taxed as income for the year in which it was realized by sale. Speaking for the court, Mr. Justice Field, on page 65, said:

"The question presented is whether the advance in the value of the bonds, during this period of four years, over their cost, realized by their sale, was subject to taxation as gains, profits, or income of the plaintiff for the year in which the bonds were sold. The answer which should be given to this question does not, in our judgment, admit of any doubt. The advance in the value of property during a series of years can, in no just sense, be considered the gains, profits, or income of any one particular year of the series, although the entire amount of the advance be at one time turned into money by a sale of the property. The statute looks, with some exceptions, for subjects of taxation only to annual gains, profits, and income."

And further, on page 66:

"The mere fact that property has advanced in value between the date of its acquisition and sale does not authorize the imposition of

the tax on the amount of the advance. Mere advance in value in no sense constitutes the gains, profits, or income specified by the statute. It constitutes and can be treated merely as increase of capital."

Respecting this decision, the Supreme Court in Lynch v. Turrish, 247 U. S., 221, speaking by Mr. Justice McKenna, said on page 230, after discussing Gray v. Darlington:

"This case has not been since questioned or modified," and meets the Government's attempt to distinguish Gray v. Darlington, on page 230, in the following manner:

41 "The Government, however, makes its view depend upon disputable differences between certain words of the two acts. It urges that the act of 1913 makes the income taxed one 'arising or accruing' in the preceding calendar year, while the act of 1867 makes the income one 'derived.' Granting that there is a shade of difference between the words, it can not be granted that Congress made that shade a criterion of intention and committed the construction of its legislation to the disputes of purists. Besides, the contention of the Government does not reach the principle of Gray v. Darlington, which is that the gradual advance in the value of property during a series of years in no just sense can be ascribed to a particular year, not therefore as 'arising or accruing,' to meet the challenge of the words, in the last one of the years, as the Government contends, and taxable as income for that year or when turned into cash. Indeed, the case decides that such advance in value is not income at all, but merely increase of capital and not subject to a tax as income."

The meaning of the word "incomes" in the sixteenth amendment is no broader than its meaning in the act of 1867. It was adopted in its present form, using only the words "incomes from whatever source derived" with the presumptive knowledge on the part of Congress and the several State legislatures, of the meaning attributed thereto by the decisions of the various courts, both State and Federal.

It has been held repeatedly that gains realized from the sale of capital assets held in trust are not income, but are principal—exactly as the securities were before they were sold, and that where a tenant for life is entitled to the entire net income of a fund, and the trustee realizes an advance in value by the sale of an investment, the life tenant is not entitled to the gain which is uniformly treated by the courts as an increment to principal and a part of the corpus of the trust.

The following are a few of the leading cases sustaining the doctrine that the growth or increase of value when realized on the sale

42 of an investment is accretion to capital and not income as between life tenant and remainderman: Boardman v. Mansfield, 79 Conn., 634; Carpenter v. Perkins, 83 Conn., 11, 20; Parker v. Johnson, 37 N. J. Eq., 366, 368; Outcault v. Appleby, 36 N. J. Eq., 74, 78; Matter of Gerry, 103 N. Y., 445; Thayer v. Burr, 201 N. Y., 155, 157, 158; Graham's Estate, 198 Pa. St., 216; Neele Estate (No. 2), 207 Pa. St., 446; Lauman v. Foster, 157 Iowa, 275; Slocum v. Ames,

19 R. I., 401; Jordan v. Jordan, 192 Mass., 337; Mercer v. Buchanan, 132 Fed., 501, 508.

These decisions had at the time of the adoption of the sixteenth amendment, established a definite meaning of the word "income" for the purpose of statutory and constitutional construction. It is difficult to see how the word "income" can have any different meaning when applied to the proceeds of an investment when held by a trustee than when held by an individual, as the income-tax law specifically refers to funds held in trust. (Sec. 2 (b).)

In order to show the conclusions reached by the courts it will suffice to quote from only one of the cases to which reference is made, supra. In Parker v. Johnson, 37 N. J. Eq., 366, the court said:

"The profit is not income. It was made by the trustee in the process of converting the investment, and, like a premium realized on the sale of Government bonds in which the funds might be invested, it belongs to the fund. The trustee in this case is to keep the fund invested, and the tenant for life is entitled to the interest. It is clearly the duty of the trustee to apply the profits on one investment to making up the losses on others."

So it seems that income from investments consists, in the case of bonds, of interest; in the case of stocks, of dividends. There is no income from the sale of investments.

43 The conclusion seems imperative that the word "income" has a well-defined meaning, not only in common speech but also under judicial construction, and this meaning does not include the increase in value of capital assets when realized upon a sale.

The following extract from the opinion of Mr. Justice Pitney in the Macomber case, supra, at page 206, is instructive:

"For the present purpose we require only a clear definition of the term 'income' as used in common speech, in order to determine its meaning in the amendment."

It seems to be apparent that the Supreme Court, in Towne v. Eisner, 245 U. S., 418, 426, and in Eisner v. Macomber, supra, followed the doctrine enunciated in Gibbons v. Mahon, 136 U. S., 549, where it was held that a stock dividend is an accretion to capital and not income as between a life tenant and the remainderman, and therefore held in the Towne case that a stock dividend was not income within the meaning of the income tax law of 1913, and in the Macomber case that such a stock dividend was not income within the meaning of the sixteenth amendment. As already stated, it is difficult to see why any different rule should be applied to the proceeds of an investment—purely a capital investment—when held by a trustee than when held by an individual.

Two pertinent points have been definitely established by the Supreme Court in Eisner v. Macomber, supra, page 214:

First. "Enrichment through increase in value of capital investment is not income in any proper meaning of the term."

and

Second. "If it requires conversion of capital in order to pay the tax, it must follow that the tax is on capital increase and not on income, for on page 213 the court said:

44 "Yet, without selling, the shareholder, unless possessed of other resources, has not the wherewithal to pay an income tax upon the dividend stock. Nothing could more clearly show that to tax a stock dividend is to tax a capital increase, and not income, than this demonstration that in the nature of things it requires conversion of capital in order to pay the tax."

Had the plaintiff possessed no resources other than the bonds which he sold—prior to the sale his capital would have been their then entire value. The increase since March 1, 1913, was capital increase. To collect the tax on this increase in value because the capital was converted into cash must of necessity diminish his capital to that extent. Before the sale all the plaintiff possessed was capital without any part of it constituting income. The sale of capital results only in changing its form, and like the mere issue of a stock dividend, makes the recipient no richer than before. Gibbons v. Mahon, supra; Towne v. Eisner, supra; Eisner v. Macomber, supra.

The exact question presented in this case has not been before the Supreme Court since its decision in Gray v. Darlington, supra, nor did it arise in Eisner v. Macomber, supra. Notwithstanding certain passages in the opinion of the court in the Macomber case stating that when dividend stock is sold at a profit, the profit is taxable like other income—which I consider, in view of all that has been written by the Supreme Court in a long line of income tax decisions, must mean that the profit derived from such transactions, if it is income, applies in the case of a trader and not in the case of an individual who merely changes his investments.

Therefore, under the authority of Gray v. Darlington, which is approved in Lynch v. Turrish, supra, I feel constrained to

45 hold that the appreciation in value of the plaintiff's bonds, even though realized by sale, is not income taxable as such, and in reaching this conclusion I find support for it in the Macomber case, where Mr. Justice Pitney says:

"Enrichment through increase in value of capital investment is not income in any proper meaning of the term."

It follows that the income tax law of 1916, in so far as it attempts to tax such increase, is in conflict with the apportionment requirements of the first article of the Constitution, being a direct tax and not apportioned among the several States according to population.

Counsel for plaintiff contended that the act should be so construed as to limit the tax to the actual increase from the dates of acquisition, although the value of such bonds was less on March 1, 1913, than when acquired prior thereto, in the event that the gain in value of the bonds when sold was taxable at all. In view of the decision that such increases are not income it becomes unnecessary to discuss the point.

The conclusion herein expressed has been reached only after a very careful consideration of all the respective claims presented by able counsel in exhaustive and persuasive briefs and with full appreciation of the admonition given by the Supreme Court in Nicol v. Ames, 173 U. S., 509, at page 514. This court fully appreciates that—

"It is always an exceedingly grave and delicate duty to decide upon the constitutionality of an act of the Congress of the United States,"

and that—

"the duty imposed demands in its discharge the utmost deliberation and care and invokes the deepest sense of responsibility"—

as was said by Chief Justice Fuller in the opening paragraph
46 of the opinion in Pollock v. Farmers' Loan & Trust Co., 158 U. S., 601, at page 617. In the discharge of that duty, as I see it, it follows that the word "incomes" in the sixteenth amendment should not and can not be so construed as to include property other than income even if such property is described as income by an act of Congress, as such a construction permits the Congress to nullify the provisions of the second section of Article I of the Constitution, that direct taxes shall be apportioned.

Let judgment be entered for the plaintiff to recover of the defendant $17,756.79, with interest on the same from July 19, 1918, together with costs of suit.

Ordered accordingly.

(Signed) THOMAS, *D. J.*

December 16, 1920.

47 United States District Court, District of Connecticut.

At a stated term of the District Court of the United States for the District of Connecticut, held at the United States courthouse in the city of Hartford, State of Connecticut, in said district, on the 16th day of December, A. D. 1920.

Present: The Honorable Edwin S. Thomas, judge.

FREDERICK F. BREWSTER, OF NEW HAVEN, in the State and District of Connecticut, plaintiff.	
vs.	
JAMES J. WALSH, COLLECTOR OF INTERNAL revenue of the United States for the district of Connecticut, of Hartford, in the State and District of Connecticut, defendant.	No. 2133. At law.

JUDGMENT.

This action by complaint claiming $17,756.79 damages with interest thereon from the 19th day of July, 1918, came to this court on the first Monday in March, 1919, and thence by continuance to

the eighth day of June, when the parties appeared by their respective attorneys and were at issue as on file, and filed herein an agreed statement of facts entitled "Stipulation and statement of facts" and signed by the attorneys for the plaintiff and defendant, respectively, which agreed statement of facts is ordered to be filed and made a part of the record in this cause, and the facts therein set forth are found to be facts.

And thereupon, neither party desiring to introduce additional evidence, and the parties having waived a jury, by consent of the
48 parties this cause was submitted to the court, in lieu of a jury, upon said stipulation of facts, the pleadings and upon argument and briefs of counsel; upon consideration whereof the court is of opinion to and doth find the issues for the plaintiff and assess his damages at $17,756.79, together with the sum of $2,568.65 interest thereon from July 19th, 1918, at the rate of six per centum per annum, making a total of $20,325.44 as of this date, and the decision of the court is set forth in a written opinion, filed herein and made a part of the record in this cause.

Whereupon it is adjudged that the plaintiff, Frederick F. Brewster, recover of and from the defendant, James J. Walsh, collector of internal revenue, the sum of $20,325.44, with interest thereon from this day until paid.

BY THE COURT.

Attest:

C. E. PICKETT, *Clerk.*

Approved as to form.

Clerk.

ALLAN K. SMITH,
Assistant United States Attorney.

December 16, 1920.

49 In the United States District Court for the District of Connecticut.

FREDERICK F. BREWSTER, PLAINTIFF,
vs.
JAMES J. WALSH, COLLECTOR OF INTERNAL REVENUE, DEFENDANT.

ASSIGNMENT OF ERRORS.

The defendant above named hereby assigns error to the record and proceedings, and to the judgment entered in the above entitled cause as follows:

1. The court erred in ordering the entry of judgment for the plaintiff.

2. The court erred in holding that the difference realized on sales of securities in the year 1916 over their fair market value on the 1st day of March 1913, as set forth in the complaint, answer and

agreed statement of facts were not taxable as income within the intent and meaning of the revenue act of 1916 or of any other applicable act.

3. The court erred in holding that the differences in the amounts between the value of investment securities, i. e., bonds of the International Navigation Company and the International Mercantile Marine Company, on March 1st, 1913, and the amounts received for such securities when sold in 1916, is not taxable income within the income tax law of 1916 or any other applicable act.

4. The court erred in holding that prior to the adoption of
50 the sixteenth amendment to the Constitution of the United States, the Congress had no power whatever to tax as income, gains arising from the sale of property where the owner thereof was not a dealer or trader in such property, so as to justify an excise tax upon his business.

5. The court erred in holding that the meaning of the word "income" does not include the increase in value of capital assets when realized upon a sale.

6. The court erred in holding that the appreciation in value of the plaintiff's bonds, even though realized by sale, is not income taxable as such.

7. The court erred in holding that the tax assessed as alleged in the complaint, answer and agreed statement of facts, and the revenue act of 1916, and any other applicable act, in so far as the same have been or may be construed or enforced as imposing said tax, were unconstitutional and void, and in violation of Article I, section 2, clause 3 of the Constitution of the United States, as a direct tax and not apportioned among the several States according to population.

8. The court erred in holding that the tax assessed as alleged in the complaint, answer and agreed statement of facts, and the revenue act of 1916, and any other applicable act, in so far as the same have been or may be construed or enforced as imposing said tax, were unconstitutional and void, and in violation of Article I, section 9, clause 4 of the Constitution of the United States, as a direct tax not laid in proportion to the census or enumeration therein mentioned.

9. The court erred in holding that the growth or increment of value in property held for investment, when realized by the sale of such property, is not taxable as income under the revenue act
51 of 1916, or under any other applicable act.

10. The court erred in holding that the growth or increment of value in property held for investment, when realized by the sale of such property, is not income within the meaning of the word "incomes" as set forth in the sixteenth amendment to the Constitution of the United States.

11. The court erred in holding that the tax alleged in the complaint, answer, and agreed statement of facts was not a tax on income within the meaning of the revenue act of 1916, or any other applicable act.

12. The court erred in holding that the tax alleged in the complaint, answer, and agreed statement of facts was not a tax on incomes within the meaning of the sixteenth amendment to the Constitution of the United States.

13. The court erred in holding that the revenue act of 1916 or any other applicable act, in so far as the same has been or may be construed and enforced as imposing a tax as set forth in the complaint, answer, and agreed statement of facts, is not authorized by the sixteenth amendment to the Constitution of the United States.

Dated at Hartford, Connecticut, this 3rd day of February, A. D. 1921.

ALLAN K. SMITH,
Assistant United States Attorney,
Attorney for Defendant.

52 District Court of the United States, District of Connecticut.

FREDERICK F. BREWSTER,
vs.
JAMES J. WALSH, COLLECTOR OF INTERNAL REVENUE.

STIPULATION CONCERNING RECORD.

It is hereby stipulated that the record on the writ of error to the District Court of the United States for the District of Connecticut in the above-entitled action consist of the following:

1. Writ or error.
2. Certification of record by clerk.
3. Petition for writ of error.
4. Order allowing writ of error.
5. Complaint.
6. Answer, omitting, however, Exhibit A attached thereto.
7. Reply.
8. Stipulation and statement of facts.
8½. Stipulation waiving jury.
9. Opinion of Hon. Edwin S. Thomas.
10. Judgment.
11. Assignments of error.
12. Stipulation concerning record.
13. Citation.

Dated at New Haven, Connecticut, this 5th day of February, A. D. 1921.

HENRY F. PARMALEE,
Attorney for Plaintiff.
ALLAN K. SMITH,
Assistant U. S. Attorney,
Attorney for defendant.

By the Honorable Edwin S. Thomas, judge of the District Court of the United States for the District of Connecticut, in the Second Circuit, to Frederick F. Brewster, greeting:

You are hereby cited and admonished to be and appear before the United States Supreme Court, to be holden at the city of Washington, within thirty days from the date hereof, pursuant to a writ of error filed in the clerk's office of the District Court of the United States for the District of Connecticut, wherein James J. Walsh, collector of internal revenue, is plaintiff in error and you are defendant in error, to show cause, if any there be, why the proceedings and judgment in said writ of error mentioned should not be corrected and speedy justice should not be done in that behalf.

Given under my hand in the city of New Haven, in the district and circuit above named, this fourth day of February, in the year of our Lord one thousand nine hundred and twenty-one, and of the Independence of the United States the one hundred and forty-fifth.

EDWIN S. THOMAS,
Judge of the District Court of the United States for the District of Connecticut, in the Second Circuit.

Due and legal service of the foregoing citation on appeal is hereby accepted this 4th day of February, 1921.

H. F. PARMALEE,
Attorney for the Plaintiff.

(Endorsement on cover:) File No. 28099. Connecticut, D. C. U. S. Term No. 742. James J. Walsh, collector of internal revenue, plaintiff in error, vs. Frederick F. Brewster. Filed February 16th, 1921. File No. 28099.

Office of the clerk, Supreme Court, U. S. Received Feb. 16, 1921.